No. 14868

In the United States Court of Appeals for the Ninth Circuit

BESSIE LASKY AND JESSE L. LASKY, PETITIONERS

v.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

ON PETITIONS FOR REVIEW OF THE DECISIONS OF THE TAX COURT OF THE UNITED STATES

BRIEF FOR THE RESPONDENT

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OPINIONS BELOW

The opinion of the Tax Court (R. 62-92) rendered after the original hearing is reported at 22 T. C. 13; the memorandum opinion of the Tax Court after rehearing (R. 138-144) is not reported.

JURISDICTION

The Commissioner contends that this Court is without jurisdiction to decide the instant consolidated cases inasmuch as taxpayers failed to file petitions for review within three months after the Tax Court decisions were rendered. The facts upon which the Commissioner's contention is based and the reasons in support of it are

fully set forth in his motion to dismiss for lack of juris diction and brief in support of the motion printe under separate cover. *Accordingly, only alternativel and in the event that this Court disagrees with the Com missioner's contention with respect to jurisdiction an denies his motion to dismiss for lack of jurisdiction i consideration of the within brief on the merits re quested, or does it become pertinent.*

The Commissioner under date of November 28, 1949 determined deficiencies in income tax for the year 194 in the case of Bessie Lasky in the amount of $224, 722.55 and in the case of Jesse L. Lasky in the amoun of $224,515.14. (R. 10-14, 62, 158.) Within ninet days thereafter and on January 9, 1950, each of th taxpayers filed a petition with the Tax Court for re determination of the deficiency under the provision of Section 272 of the Internal Revenue Code of 1939 (R. 1, 14.) The final order and decision of the Tax Court was rendered in each case on April 8, 1954 (R 92-93), determining deficiencies in income tax due fron taxpayer Bessie Lasky for 1943 in the amount of $224, 722.55 and in the case of Jessie L. Lasky for 1943 i the amount of $224,515.14.

Under date of August 24, 1954, taxpayers moved th Tax Court to vacate the decisions entered on April 8 1954 (R. 94), and on October 11, 1954, taxpayers move to amend the motion to vacate the decisions of Apri 8, 1954, by in substance adding "for the purpose o granting petitioners a rehearing of the case on its merits" (R. 134). By an order dated December 13 1954, which for reasons stated in the Commissioner's motion to dismiss for lack of jurisdiction, the Commis sioner contends was erroneously made, the Tax Court granted taxpayers' amended motion and ordered tha

its decision in each of the two above-entitled cases entered on April 8, 1954, be vacated and set aside for the purpose of granting taxpayers a further hearing on the merits. (R. 135.) Under date of June 30, 1955, the Tax Court made its order and decision in each of the above-entitled cases (R. 138-141, 144-145) after rehearing, adhering to its original opinion and decision, and determining deficiencies in the same amounts, as determined in its orignal decisions of April 8, 1954, namely, in the case of taxpayer Jesse L. Lasky, $224,515.14 (R. 141) and in the case of Bessie Lasky in the amount of $224,722.55 (R. 144-145). The Commissioner contends in his said motion that the Tax Court was without jurisdiction to render these decisions of June 30, 1955.

Taxpayers seek to bring the case to this Court by petitions for review filed on August 10, 1955 (R. 6, 145-149), which the Commissioner contends were not duly filed pursuant to the provisions of Section 1142 of the Internal Revenue Code of 1939 and Section 7483 of the Internal Revenue Code of 1954 within three months after the Tax Court's decisions were rendered and that therefore these petitions are insufficient to confer jurisdiction upon this Court to hear the instant case. Only in the event that this Court overrules the Commissioner's motion to dismiss and holds that the Tax Court possessed jurisdiction to vacate its decisions of April 8, 1954, and to enter the purported decisions on rehearing of June 30, 1955, would the petitions for review be timely under the statute.

QUESTION PRESENTED

Whether on the record facts the Tax Court was clearly wrong in concluding that the sum of $805,000,

which taxpayer Jesse L. Lasky received in 1942, was ordinary income and not capital gain.

STATUTE INVOLVED

Internal Revenue Code of 1939:

SEC. 22. GROSS INCOME.

(a) *General Definition.*—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service, of whatever kind and in whatever form paid or from professions, vocations, trades, businesses commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. * * *

* * * * *

(26 U.S.C. 1952 ed., Sec. 22.)

SEC. 117. CAPITAL GAINS AND LOSSES.

(a) *Definitions.*—As used in this chapter—

(1) [As amended by Sec. 115(b) of the Revenue Act of 1941, c. 412, 55 Stat. 687, and Sec. 151(a) of the Revenue Act of 1942, c. 619, 56 Stat. 798] *Capital assets.*—The term "capital assets" means property held by the taxpayer (whether or not connected with his trade or business), but does not include stock in trade of the taxpayer or other property of a kind which would

properly be included in the inventory of the taxpayer if on hand at the close of the taxable year, or property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business, or property, used in the trade or business, of a character which is subject to the allowance for depreciation provided in section 23(1), or an obligation of the United States or any of its possessions, or of a State or Territory, or any political subdivision thereof, or of the District of Columbia, issued on or after March 1, 1941, on a discount basis and payable without interest at a fixed maturity date not exceeding one year from the date of issue, or real property used in the trade or business of the taxpayer;

(2) [As amended by Sec. 150(a) of the Revenue Act of 1942, *supra*] *Short-term capital gain.* —The term "short-term capital gain" means gain from the sale or exchange of a capital asset held for not more than 6 months, if and to the extent such gain is taken into account in computing net income;

* * * * *

(4) [As amended by Sec. 150(a) of the Revenue Act of 1942, *supra*] Long-term capital gain. —The term "long-term capital gain" means gain from the sale or exchange of a capital asset held for more than 6 months, if and to the extent such gain is taken into account in computing net income;

* * * * *

(26 U.S.C. 1952 ed., Sec. 117.)

STATEMENT

Taxpayers are husband and wife, whose income in 1942 and 1943 was community income, reported on the cash basis. (R. 62-63.) Their cases were consolidated in the Tax Court (R. 151) and by order of this Court (R. 455-456) are consolidated here. Unless otherwise noted taxpayer-husband, Jesse L. Lasky, will be referred to as taxpayer.

The Commissioner determined deficiencies in income tax for 1943 as follows (R. 62):

Bessie Lasky	$224,722.55
Jesse L. Lasky	224,515.14

The year 1942 is involved because of the provisions of the Current Tax Payment Act of 1943, c. 120, 57 Stat. 126. (R. 62.)

Based on the testimony of witnesses adduced at a hearing held on December 10-11, 1951 (R. 2, 150-299), and rehearing held January 21 and 26, 1955 (R. 5, 300-385), a stipulation of facts (R. 19-23), and documentary evidence, the Tax Court made the following fact findings:

Taxpayer's occupation has been that of a motion picture producer since 1913, and he has produced many pictures. He has been a producer for various corporations in which he was an officer such as Jesse L. Lasky Star Players Company, Famous Players-Lasky Company, Paramount Famous-Lasky Company, R.K.O., Fox Film Corporation, and Pickford-Lasky Corporation. (R. 63.)

Taxpayer was the producer of a radio show called "Gateway to Hollywood" from 1938 to the early part of 1940. For three months in the early part of 1940,

taxpayer was not associated with or engaged in any production, and he was not associated with any corporation. (R. 63.)

Prior to March, 1940, Lasky, as an individual, had not purchased any literary property, but as vice-president in charge of production of Paramount, many literary properties passed through his hands. When he was an officer of Jesse L. Lasky Star Players Company, and when he was in charge of production of Famous Players-Lasky Company he became acquainted with the procedures followed by those companies in purchasing plays, stories, and literary properties. (R. 63.)

In the early part of 1940, in Jamestown, Tennessee, taxpayer negotiated with Alvin York, a hero of World War I, for the purchase of the motion picture and other rights in the life story of Alvin York. On March 23, 1940, York and Lasky entered into a written agreement (Ex. 1-A, R. 23-38) under whose terms York sold to Lasky, inter alia, the exclusive motion picture rights in the story of Sergeant York, and, in particular, in three published books, "Sergeant York and His People", "Sergeant York, Last of Long Hunters", and "The War Diary of Sergeant York". In consideration for all the rights received, Lasky agreed to pay York $25,000 upon the execution of the agreement, and $25,000 at the expiration of either 18 months from the date of the execution of the agreement, or upon the date following the release of any motion picture made pursuant to the agreement, whichever date was earlier. Failure to pay the second $25,000 would result in termination of the agreement. In addition, Lasky agreed to pay York a sum equal to 4% of gross receipts from the distribution of each motion picture in excess of $3,000,000; 5%, in excess of $4,000,000; 6%, in excess of $6,000,000; and

8%, in excess of $9,000,000. It was expressly provide that if the contract should be assigned to a productio or distribution corporation the assignee would assum all of Lasky's obligations. Lasky paid York $25,00 upon the execution of the agreement. He borrowed th funds used to make the payment. (R. 63-64.)

Taxpayer, thereafter, flew to Hollywood, California where he arrived on about March 25, 1940. Lask shopped around to sell the story for production of motion picture. He had an outline of a story which h gave Sam Goldwyn to read. He called on Paramoun also. None of the first contacts wanted the story. H then called on Harry and Jack Warner of Warne Brothers Pictures, Inc. Warner Brothers agreed t purchase the rights to the story of Sergeant York an to employ Lasky as the supervising producer. The un derstanding of Warner Brothers and Lasky was reache a few weeks before written instruments were ready fo execution. The agreements executed and the date thereof were as follows: (1) One agreement was date May 8, 1940, by which Warner Brothers employed Lask as the supervising producer of a photoplay tentatively entitled "The Amazing Story of Sergeant York". (Ex D, R. 385-408.) (2) Another agreement was dated Ma 15, 1940, by which Lasky sold to Warner Brothers al of his rights to the York story and all other rights h had acquired under the York contract of March 2 1940. (Ex. 2, R. 38-41.) Another agreement was simul taneously executed, entitled "Supplemental Agree ment", which was dated May 15, 1940, by which Warne Brothers agreed to pay Lasky part of the gross receipts in varying percentages, from the distribution of th photoplay, "The Amazing Story of Sergeant York" (Ex. 3, R. 41-47) (R. 64-65.)

The agreement of May 8, 1940, was for an original term of 52 weeks beginning, retroactively, on April 1, 1940, with options to extend the period of the agreement for a maxmium period of seven years. The agreement provided, inter alia, as follows (R. 65-66):

> 13. It is understood that the Company has purchased from the Producer, all Producer's rights to, in and under certain agreement dated March 23, 1940, between the Producer and Alvin C. York, the original of which contract has been delivered to the Company, and which rights are of value in connection with the production of the proposed photoplay, "The Amazing Story of Sergeant York", referred to in Paragraph 3 hereof. The Company shall be entitled to the services of Producer in the preparation and/or writing of the script upon which said motion picture photoplay shall be based, but it is not a condition or prerequisite to the production of said photoplay that said script shall be approved by Producer, and on the contrary Producer agrees to render his services in the complete production of said photoplay provided only said script meets with the approval of the Company. It is further understood that Producer shall work under the direct supervision of Jack L. Warner and Hal B. Wallis, or either of them, provided either of them remain in the employ of the Company during the term hereof; * * *.
>
> 14. It is further agreed that Producer shall be accorded credit on the film of the photoplay produced hereunder and in all paid advertising and publicity issued by and under the direct control of the Company in approximately the following form,

to-wit: "Produced by Jesse L. Lasky and Hal B. Wallis."

In general, the agreement provided that Lasky would render services as the supervising producer of the York photoplay, and such other photoplay as might be selected by mutual consent, for a period of 52 weeks from April 1, 1940; that Lasky, at the option of Warner Brothers, would render additional services in connection with the preparation or writing of the script, and editing, supervising, and overseeing the development of the screen play; and that Lasky would receive for all of his services under the contract at least $60,000 payable at the rate of $1,500 per week. (R. 66-67.)

Under the agreements of May 15, 1940, Warner Brothers, in general, agreed to pay Lasky $40,000 for all of his right, title, and interest in the York agreement of March 23, 1940, plus a part of the gross receipts from domestic and foreign distribution during not more than five years after the date of release of the York photoplay. Warner Brothers assumed all of Lasky's obligations under the York contract. (R. 67.) The so-called "Supplemental Agreement" provided, in part, as follows (R. 67-68):

> Whereas, the parties hereto have simultaneously herewith entered into a contract whereby Warners have purchased all the right, title and interest of Lasky in and under a certain contract between Lasky and Alvin C. York, dated March 23, 1940, relating to a motion picture tentatively entitled, "The Amazing Story of Sergeant York", as in said contract set forth,
>
> Now, therefore, it is further agreed that as an additional compensation and consideration payable

to Lasky by Warners for the rights contained in the aforesaid contract Warners will pay to Lasky a further sum based upon the gross returns from the release and/or distribution and/or exhibition of the said photoplay, as follows: * * *

2. Warners will pay Lasky a sum equal to twenty per cent (20%) of the gross film rentals or sales (as hereinafter defined) realized from such motion picture in excess of the sums hereinafter stated. The term "gross film rentals or sales", as used herein, shall be deemed to be the aggregate of the domestic proceeds and the foreign proceeds realized from the sale, rental or distribution of the photoplay contemplated hereunder. * * * Warners will pay Lasky the said sum of twenty per cent (20%) upon the said domestic proceeds in excess of One Million Six Hundred Thousand Dollars ($1,600,000.00) and a similar percentage of the foreign proceeds in excess of One Hundred and Fifty Thousand Dollars ($150,000.00); * * * It is further understood that should the aggregate proceeds, both domestic and foreign, reach the sum of Two Million Five Hundred Thousand Dollars ($2,500,000.00), then thereafter Warners will pay Lasky a sum equal to twenty-five per cent (25%) of the excess above such figure instead of twenty per cent (20%) as is herein provided for proceeds below such figure.

Warner Brothers agreed, also, to keep complete books of account pertaining to receipts from the distribution of the photoplay, and to make such records available at all times to Lasky or his agents. Warner Brothers

agreed to render periodical statements to Lasky after the release of the picture, not less than once each quarter, accounting for receipts, and to make simultaneous payment to Lasky of his share of the gross receipts shown by each statment. (R. 68-69.)

The so-called "Supplemental Agreement" of May 15, 1940, is the type of agreement which is known as a participation agreement. (R. 69.)

Warner Brothers paid $40,000 to Lasky in 1940, as provided in the agreement of May 15, 1940. Warner Brothers reported the payment of $40,000, on Form 1099 of the Treasury Department as a payment for "Sale of Story". (R. 69.)

Lasky went on Warner Brothers' payroll as of April 4, 1940. He was paid $58,500 during 1944 for his services as a producer during 39 weeks. Warner Brothers reported payment of $58,500 as "salary" on Form 1099. (R. 69.)

Lasky reported the sums of $40,000 and $58,500 as ordinary income in his income tax return for 1940. (R. 69.)

A photoplay entitled "Sergeant York" was produced; it was released in the United States and Canada in July, 1941. (R. 69.)

Lasky's employment as a producer of the photoplay extended over 58½ weeks, from April 4, 1940, to May 17, 1941. Lasky was paid $87,750 for his services at the rate of $1,500 per week. (R. 69.)

Lasky was employed by Warners Brothers in the production of other pictures during 1941, 1942, 1943, and 1944. He went back on the payroll on May 19 1941, in connection with a photoplay about Mark Twain. He worked on that project intermittently until Jan-

uary 9, 1943, for a period of 77 weeks, receiving total compensation of $126,175, for his services as an associate producer. From January 11, 1943, until April 24, 1944, Lasky worked for Warner Brothers during 83 weeks on "various" projects receiving $150,516.67 for his services as an associate producer. (R. 69-70.)

Warner Brothers followed the practice of mailing statements to Lasky which were designated "Statement to Jesse L. Lasky covering distribution of production 'Sergeant York' to (date)," together with a check for the amount of Lasky's participating share as shown by the statement. Lasky's share was 20%, at first, under the agreement. The first of such statements was mailed to Lasky with a letter dated December 15, 1941. The statement was for the period ending November 29, 1941, and showed the following (R. 70):

Gross income from distribution within U.S.	$1,706,084.02
Less—gross rentals (U.S.) in which participant does not share	1,600,000.00
Net on which participant shares	$ 106,084.02
Participant's share—20%	$ 21,216.80

Lasky received a check for $21,216.80 with this statement. (R. 70.)

An account was set up on the books of Warner Brothers entitled "Income from Distribution of Production 'Sergeant York' and Jesse L. Lasky's Share Thereof". This account showed gross receipts from domestic and foreign distribution. The account was periodically credited with Lasky's share of gross receipts pursuant to the "Supplemental Agreement" of May 15, 1940. The account showed the total amount of credits before a new crediting of his share, the

amount of his participating share as of a particular date, and the total "to date". It also showed certain charges against Lasky's account. A record was kept of the checks of Warner Brothers which were made payable to Lasky, and the amounts thereof. (R. 70-71.)

At the end of 1941, Lasky made two separate requests to Warner Brothers to make advances to him of his 20% share of gross receipts. His first request was for an advance payment of $85,000, and his second request was for an advance payment of $90,000, a total amount of $175,000. Warner Brothers made the payments requested by check. (R. 71.)

In 1941, Lasky received $196,216.80 from the gross receipts from the distribution of the York picture which he reported in his return for 1941 as ordinary income ($21,216.80, plus $175,000). (R. 71.)

As consideration for the two advance payments in 1941 of $175,000, Lasky agreed to modifications of the "Supplemental Agreement" of May 15, 1940. The amendments were made by letters of Warner Brothers to Lasky, which he signed as "Accepted", dated December 30, 1941 (Ex. 4, R. 48-51), and December 31, 1941 (Ex. 5, R. 51-54). (R. 71).

As consideration for the advance payments of $175,000, Lasky agreed that he would begin to share in the earnings of "Sergeant York" after the gross film rentals reached $2,580,000 instead of $1,600,000, as previously agreed. If Lasky had waited to receive the 20% first agreed upon, his share would have been $196,000. Therefore, the receipt of the advance payments of $175,000 represented a discount of the first $196,000 of earnings for $21,000. Lasky gave Warner Brothers a discount in order to receive payments in 1941 in advance. (R. 74-75.)

By another "letter agreement" dated April 30, 1942 (Ex. 6, R. 55-56), Lasky agreed to pay (and he authorized Warner Brothers to withhold and keep from any sums due him under the Supplemental Agreement of May 15, 1940, as amended) the sum of $18,998 to be expended by Warner Brothers in an advertising campaign of the picture "Sergeant York". This sum was withheld by Warner Brothers prior to December 4, 1942. (R. 75-76.)

At some time prior to May 1942, a claim based upon alleged plagiarism was lodged against Warner Brothers and Lasky by the heirs of Skeyhill, the author of "Sergeant York, Last of Long Hunters". Warner Brothers tentatively debited taxpayer's account on its books in the amount of $10,000 as a safeguard against possible costs arising out of such claim. Of this debit, all but $239.75 was ultimately recredited to taxpayer's account. (R. 76.)

On about May 6, 1942, Lasky instructed Warner Brothers to send future statements of account and participation checks, and other matters directly to his attorney. (R. 76.)

Lasky consulted and retained a certified public accountant who specialized in motion picture accounting and in the investigation of motion picture distribution and participation accounting. Lasky and his attorney consulted the accountant about Lasky's rights under the "Supplemental Agreement" of May 15, 1940, as amended, with the purpose of securing a proper accounting of proceeds from Warners under the contract. (R. 76.)

Under date of May 6, 1942, Warner Brothers mailed to Lasky's attorney in Los Angeles, a statement pur-

porting to show the domestic and foreign receipts from the distribution of "Sergeant York" to February 28 1942, and Lasky's share thereof, together with its check made payable to Lasky, in the amount of $244,529.84 The statement showed, among other things, United States gross feature rentals to February 28, 1942, in the amount of $3,758,978.57, without detailed explanation The statement listed foreign income to February 28 1942, as $85,613.15, against which was offset $150,000 the latter was described as "Income on which participant does not share". The statement disclosed that "The sum of $10,000.00 has been withheld at this time by reason of the claim of alleged Skeyhill heirs." (R 76-77.)

There was attached to the check of Warner Brothers for $244,529.84, a voucher which was a permanent part of the check form. The voucher bore the legend "Void If Detached". On the voucher was typed the number of the voucher and "Your share of income from distribution of production 'Sergeant York' per statements rendered as of February 28, 1942, $244,529.84." A letter which accompanied the check described the check as "covering the amount shown by the statement to be due." (R. 77.)

Lasky was advised by his attorney not to accept the check for $244,529.84. With the approval of Lasky his attorney returned the check to Warner Brothers Pictures, Inc., by registered mail on June 3, 1942, with the following statement: "I am unable to accept the check for Mr. Lasky under the conditions as sent—." (R. 77.)

On July 10, 1942, Warner Brothers mailed taxpayer's attorney another check made payable to Lasky in the

amount of $132,692.08. On October 13, 1942, Warner Brothers mailed taxpayer's attorney another check made payable to Lasky in the amount of $193,476.70. Each check was accompanied by a statement showing the gross rentals of the York photoplay, domestic and foreign, to May 10, 1942, and to August 29, 1942, respectively, and Lasky's share up to each date. A voucher was attached to each check with the legend "Void If Detached". (R. 77-78.)

Taxpayer's attorney returned the checks for $132,692.08, and $193,476.70, to Warner Brothers with letters stating in each instance: "We are unable to accept this check under present conditions, and for that reason I am compelled to return the same." (R. 78.)

The three checks which were received by Lasky's attorney in 1942 and which were returned in 1942 totaled $570,698.62. Upon receipt of the returned checks, Warner Brothers stamped them "Void". (R. 78.)

No investigation was ever made on Lasky's behalf by his accountant or agents of Warner Brothers' records of the receipts from the distribution of the York photoplay to determine whether or not Lasky was receiving a fair accounting of his participating share of the receipts, or to determine any other matters. (R. 78.)

After the return to Warner Brothers of the three checks totaling $570,698.62, Warner Brothers did not send any more statments or any more checks to Lasky or to his attorney in payment of Lasky's participation in the York picture rentals. However, on its books, Warner Brothers continued to make credits to Lasky's account as it had done previously. (R. 78.) Exhibit Z (R. 434-438), a copy of the accounting records of Warner Brothers of Lasky's participation in the York

picture receipts shows that computations of the receipts, foreign and domestic, in which Lasky had a share, were computed as of February 28, 1942, April 4, 1942, May 2, 1942, May 30, 1942, July 4, 1942, October 3, 1942, October 31, 1942, and November 28, 1942. Also, the cumulative balances of the gross receipts on August 29, 1942, October 3, 1942, October 31, 1942, and November 28, 1942, were as follows (R. 79):

	Cumulative Total of Credits to Lasky
August 29, 1942	$570,938.37
Oct. 3, 1942	628,978.66
Oct. 31, 1942	679,013.38
Nov. 28, 1942	822,857.56

The account on the books of Warner Brothers was closed out on December 22, 1942, by the notation: "Assigned to United Artists Corporation." A check of Warner Brothers for $820,000, dated December 22, 1942, made payable to United Artists Corporation was entered in the account and was charged to the cumulative balance shown therein. Also, $2,857.56 was charged to the account as a charge to "Producer" (Lasky). The explanation written in the account for the check to United Artists in the amount of $820,000, stated, in part, as follows: "The $820,000 was in full payment of all claims of every nature arising out of the purchase of the stories as well as any share accruing from distribution of the production [the York photoplay]." (R. 79-80.)

The check for $820,000, payable to United Artists, dated December 22, 1942, bore the following notation: "Payment as per agreement dated December 22, 1942

between Warner Bros. Pictures, Inc., and United Artists Corporation." (R. 80.)

The check was paid on December 24, 1942; United Artists received payment of the check for $820,000 on December 24, 1942. (R. 80.)

In 1942, Lasky's attorney had a conference with an executive of Warner Brothers about foreign blocked funds, and the executive of Warner Brothers proposed that Lasky's share of foreign blocked funds (presumably foreign receipts from the distribution of the York picture) should be $200,000; but Lasky's attorney did not agree. Lasky's attorney discussed, at some undisclosed time, with executives of Warner Brothers criticisms which he had heard about Warner Brothers' handling of the York picture. (R. 80.)

Lasky was advised and he decided to get out of his agreement of May 15, 1940, with Warner Brothers. His attorney handled all negotiations. His attorney worked out an agreement with United Artists Corporation whereby it would pay Lasky $805,000. The agreement was consummated on December 4, 1942. United Artists was represented by its attorney. On or about December 4, 1942, Lasky received $805,000 from United Artists. (R. 80.)

United Artists, on December 22, 1942, received a check from Warner Brothers for $820,000. The check was paid on December 24, 1942. (R. 80.)

Taxpayer's attorney had been secretary-treasurer of United Artists Corporation off and on. (R. 81.)

The transaction between Lasky and United Artists was covered by an agreement which was entitled "Contract of Sale". (Ex. 7-B, R. 56-61.) It was dated December 4, 1942. Under the agreement Lasky sold and assigned to United Artists all of his interest in the

original and supplemental agreements with Warner Brothers dated May 15, 1940, and all of his interest in the motion picture "Sergeant York", including "the proceeds thereof, rights of accounting thereof, money due or to become due therefor from Warner Bros. Pictures, Inc., * * *." Under the agreement, Lasky, also, inter alia, authorized United Artists, the "purchaser", irrevocably and in his (Lasky's) name, or otherwise to do the following (Ex. 7-B, R. 56-61, 81-82):

> * * * to execute any document of any kind or character * * * and to remise, release and discharge for himself and his successors, all manner of action and actions, cause and causes of action, suits, duties, dues, sums of money, accounts, * * * claims and demands whatsoever in law or in equity which against Warner Bros. Pictures, Inc., or any other person, firm or corporation, the said Seller [Lasky] ever had, now has * * * or may have * * * relating to or in connection with the motion picture "Sergeant York," and agrees to be bound thereby as though such instruments were executed by himself, and to release and discharge Warner Bros. Pictures, Inc., from rendering any reports and accounts to him [Lasky], from paying any money to him or in anywise be responsible for or have any duties to him by virtue of or arising out of the agreements of May 15th, 1940, or any supplements or amendments thereto, and to acknowledge that Seller neither has nor shall it have any rights or interest of any kind whatsoever in and to the motion picture "Sergeant York" and to entitle Warner Bros. Pictures, Inc. to license, sell, dispose of, reissue, re-make and in every other way treat the

motion picture "Sergeant York", the negative, positive prints, stories, scenarios and other properties thereof as its sole and exclusive property without any accounting, payment or restriction of any kind to the Seller.

In consideration of all of the assignment and transfer of Lasky, "the Seller", United Artists agreed to pay Lasky, upon execution and delivery of the agreement, the sum of $805,000, in cash. (R. 82.)

On December 22, 1942, United Artists and Warner Brothers Pictures, Inc., executed an agreement entitled "Contract of Sale". (Ex. AA, R. 439-444.) Under this agreement, United Artists sold and assigned to Warner Brothers for $820,000 the contract of sale dated December 4, 1942, between Lasky and United Artists, which was attached to the contract between United Artists and Warner Brothers. United Artists, by its contract, sold and assigned to Warner Brothers all rights of every kind acquired by it under the terms of the agreement of December 4, 1942 (with Lasky), including, inter alia, its rights as follows (R. 82-84):

> * * * in and to any contract and any right thereunder or claims thereunder it may have by virtue of contracts or claims thereunder which Jesse L. Lasky may have had with Warner Bros. Pictures, Inc. or any subsidiary corporation, in and to any * * * licenses it may have any interest in pertaining to or relating to the production, distribution or exhibition of the motion picture "Sergeant York," * * * any and all right, title and interest it may have by virtue of the original contract dated May 15th, 1940 between Jesse L. Lasky and Warner

Bros. Pictures, Inc., the agreement supplemental thereto of similar date, and any and all other amendments and supplements thereto including specifically the right to all moneys that are now due or which may become due to Jesse L. Lasky from Warner Bros. Pictures, Inc., thereunder * * * and any of the rights connected with production, distribution or exhibition thereof, and any and all claims, manner of action and actions, cause and causes of action, suits, sums of money, accounts, damages and demands of any kind and character Jesse L. Lasky may have against Warner Bros. Pictures, Inc., or which arise out of or in connection with the motion picture "Sergeant York" against Warner Bros. Pictures, Inc.

(4) Pursuant to the authority granted to Seller in paragraph 4 in its said agreement with Jesse L. Lasky dated December 4th, 1942, Seller does hereby for and in the name of and on behalf of Jesse L. Lasky and his successors and assigns, remise, release and forever discharge Warner Bros. Pictures, Inc. and all of its subsidiary and affiliated corporations of and from all manner of action and actions, cause and causes of action, suits, duties, dues, sums of money, accounts, reckonings, bonds, bills, specialties, covenants, contracts, controversies, agreements, promises, variances, trespasses, damages, judgments, executions, claims, and demands whatsoever in law or in equity which against Warner Bros. Pictures, Inc. and its subsidiary and affiliated corporations the said Jesse L. Lasky now has or * * * may have in and to the receipts from the distribution and exhibition thereof or any part there-

> of and does further release and discharge the said Warner Bros. Pictures, Inc. from rendering any reports and accounts to him, from paying any money to him or in anywise be responsible for or have any duties to him by virtue of or arising out of the agreement and supplemental agreement both dated May 15, 1940 between him and Warner Bros. Pictures, Inc. and all supplements or amendments thereto, and he does hereby acknowledge that he does not have nor shall he have any rights or interest of any kind whatsoever in and to the motion picture, "Sergeant York", and Warner Bros. Pictures, Inc. is entitled to license, sell, dispose of, * * * the entire receipts for the world from the distribution and exhibition thereof as its sole and exclusive property without any accounting, demand or restriction of any kind.

Taxpayer reported, in his return for 1942, one-half of the payment of $805,000 as long-term capital gain from the sale of a capital asset, as follows: "Interest in picture Sergeant York 3-15-40—12-4-42, $402,500; gain to be taken into account, $201,250.00." Taxpayer's wife reported one-half of the same long-term capital gain in her return for 1942. (R. 84-85.)

The Commissioner rejected this treatment of the receipt of $805,000, giving the following explanation in the notice of deficiency (R. 85):

> It has been determined that $805,000 representing the proceeds from a contractual interest in the earnings and profits of the motion picture "Sergeant York" received from United Artists Corporation on December 4, 1942, is taxable as ordinary income received in the year 1942.

The Tax Court concluded upon the foregoing facts that Lasky's share in the gross rentals of the York motion picture payable to him by Warner Brothers constituted ordinary income. (R. 86-88.)

The Tax Court further concluded that it was difficult to find as a fact that a bona fide dispute existed in 1942 between Lasky and Warner Brothers, that at the most the record contains only the suggestion that Lasky and his advisers were suspicious about the possible existence of grounds for the propriety of Warner Brothers' computation of the dollar amounts of Lasky's shares, their accounting practice and procedure, and their handling of the release of the film. (R. 89.)

The Tax Court found the inference to be plain that by the end of 1942 Lasky had reached a decision to step out of his contract with Warner Brothers and terminate it. (R. 89.) By the end of November, 1942, there was credited to Lasky and unpaid on the books of Warner Brothers $822,857.56. (R. 88.) The Tax Court concluded that there was no showing of any business purpose by Lasky in his arrangement with United Artists and that the record is sparse in providing any explanation for the few days' advance of funds to Lasky, which United Artists so quickly recouped out of Lasky's account with Warner Brothers through Warner Brothers' payment of $820,000. Thus, United Artists gained $15,000 for about twenty days use of its $805,000 which it advanced to Lasky, and that was the only business aspect of the arrangement as far as United Artists was concerned. (R. 90.)

The credit balance under the Lasky-Warner Brothers agreement, $822,857.56, was closed on December 22, 1942, by payment of $820,000 by Warner Brothers to

United Artists and $2,857.56 was charged to Lasky to take care of some undisclosed charge or adjustment. (R. 90.) The Tax Court concluded that when the steps taken are seen in this light there was no more than an ending of the Warner Brothers-Lasky agreement, and Lasky received the accumulated royalties or shares due him, receipt of which had been held up. (R. 91.)

The Tax Court held that by the end of 1942 taxpayer had credited to him agreed shares of the gross film rentals. Total accrued and credited payments were paid in an amount based upon an agreement which had been carried out by the obligor to the extent of tendering payments on account. The alleged "sale" of the right to receive the accruals did not convert accrued income into capital. It was in fact only payment of the total accruals to Lasky through an intermediary. (R. 91.)

Accordingly, the Tax Court sustained the Commissioner's determination of deficiencies. (R. 92.)

Subsequently upon the basis of the additional evidence introduced at the further hearing held January 21 and January 26, 1955 (R. 5, 300-374), the Tax Court found the following additional facts (R. 141-144):

Gradwell Sears was president of Vitagraph Corporation prior to October, 1941, which was a subsidiary of Warner Brothers, which provided the film distributing facilities of Warner Brothers. He had complete charge of the distribution of the picture "Sergeant York" in the United States and its possessions. In October, 1941, he left Vitagraph and became executive vice-president of United Artists in charge of worldwide distribution. He held that office during 1942. In 1941 and 1942, Edward C. Raftery was president of United Artists. Sears knew that Lasky had a minority

interest in "Sergeant York," and that the picture was successful. He recalled that an executive of Warner Brothers lamented the fact that Warner Brothers did not own the entire interest in "Sergeant York," and he "knew from advance information that Warner Brothers would very gladly acquire the entire rights in this thing ["Sergeant York"] if they became available." He did not ever talk to Lasky in regard to purchasing Lasky's interest in "Sergeant York." He recommended that Raftery discuss the possibility of acquiring Lasky's interest with Lasky's attorney. (R 141-142.)

Before December 4, 1942, a representative of Lasky visited Warner Brothers' office and obtained some figures which he communicated to Lasky's accountant, James D. Miller, who carried on his accounting practice in New York City. Miller believed, before December 4, 1942, that under Warner Brothers' accounting, more than $805,000 was due Lasky as his share of the receipts of "Sergeant York." In October, 1942, Miller believed that the picture "Sergeant York" "had been pretty well exploited domestically"; that there would still be, perhaps, some foreign exploitation; that in all probability there would be a release of restricted funds abroad; and that there would be subsequent runs of the picture. (R. 142-143.)

In 1942, Lasky's attorney was secretary of United Artists. (R. 143.)

Lasky did not know, on December 4, 1942, or before, that United Artists might resell Lasky's interest in "Sergeant York" to Warner Brohters. Lasky did not advise Warner Brothers that he was going to sell his interest in "Sergeant York" to United Artists. He

never offered his interest for sale to Warner Brothers. Lasky knew that his attorney was negotiating for the sale of his interest in "Sergeant York." His attorney was his agent and he left all the details in his attorney's hands. (R. 143.)

Lasky's attorney approached Raftery in November, 1942, and asked him if United Artists would be interested in purchasing Lasky's interest in "Sergeant York." Lasky had authorized his attorney to look for a buyer of his interest. Raftery consulted Sears about the offer of Lasky's attorney to sell Lasky's interest in "Sergeant York" and about the alternative of making a resale of Lasky's interest so as to make a little profit during 1942. Raftery also, before December 4, 1942, spoke to an officer of Warner Brothers, told him that he had an opportunity to buy Lasky's interest in the picture in question, and inquired whether Warner Brothers would be interested in purchasing Lasky's interest if United Artists decided not to keep it. The officer of Warner Brothers to whom Raftery spoke expressed the view that if United Artists bought Lasky's interest, Warner Brothers would like to negotiate with United Artists relative to purchasing Lasky's interest from United Artists. Raftery expressed his desire to make a profit on a resale of Lasky's interest. Raftery did not deal with Lasky. He dealt only with Lasky's attorney. At the time Raftery entered into the contract of December 4, 1942, to purchase Lasky's interest he knew that Lasky was entitled to some distributions of earnings of the picture in question. He had some idea of the amount of the accrued earnings due Lasky. At the time Raftery considered purchasing Lasky's interest, he knew that the picture "Sergeant York" was

not in full distribution; the "big cream" of the distr
bution had been taken off with the "pre-release" of th
picture. He knew that as a picture progresses in dis
tribution, diminishing returns set in and the return
decrease each month, and that at the time United Ar
ists acquired Lasky's interest in "Sergeant York," i
was in the phase of declining distribution. Raftery
mind was made up from the start that United Artis
would resell Lasky's interest in "Sergeant York," an
before he agreed with Lasky's attorney to purchas
Lasky's interest he found out that he could get a pu
chaser and resell Lasky's interest. He intended makin
a short profit on a resale of Lasky's interest. (R. 14
144.)

In its order and decision entered after the rehearin
and the taking of additional evidence the Tax Cou
held that it was not persuaded by the additional ev
dence that it had erred in its original findings of fa
and conclusions of law, but that the additional evidenc
further supports the conclusions it had previousl
reached. Thus, the Tax Court was of the opinion tha
the additional evidence did not establish that in 19
any real dispute existed between Lasky and Warne
Brothers; that this evidence established that the the
president of United Artists gave consideration to th
possibility of making a resale of Lasky's interest in th
picture before he concluded the contract of purchas
with Lasky, and that before he concluded the contra
he contacted an officer of Warner Brothers and told hi
that he had an opportunity to purchase Lasky's inte
est and inquired whether Warner Brothers would b
interested in purchasing from United Artists the in
terest which United Artists contemplated purchasin

from Lasky. The Tax Court concluded that the transaction of United Artists with Lasky and the transaction of United Artists with Warner Brothers shortly thereafter must be considered together and that although Lasky may not have been aware of all of the discussions and considerations of his chief agent, his attorney, nevertheless the agent's actions must be imputed to Lasky. (R. 140-141.)

The Tax Court again concluded that Lasky sold his accrued earnings in the picture amounting to $822,857.56 to United Artists at a "discount" of over $17,000, and that United Artists collected from Warner Brothers, Lasky's share of the accrued earnings to the extent of $820,000. Thus Warner Brothers acquired Lasky's interest for no more than the accrued earnings of that interest. The Tax Court held once more that it was unable to find in the entire transaction a sale by Lasky of a capital asset and a capital gain to Lasky of $805,000. (R. 141.)

Accordingly it sustained, as it had upon the original hearing, the Commissioner's determinations of deficiency. (R. 141, 144-145.)

SUMMARY OF ARGUMENT

The record amply sustains the Tax Court in concluding that the sum of $805,000 which taxpayer received in 1942 is taxable as ordinary income and not as capital gain. Under the record facts all payments which taxpayer received from Warner Brothers were ordinary income. Indeed taxpayer reported as ordinary income the sums paid to him by Warner Brothers during the years 1940 and 1941 including $196,216 which Warner Brothers paid him in 1941 from his share of the gross receipts of the distribution of the

York picture under the so-called "Supplemental Agree ment" of May 15, 1940.

If the $805,000 paid to taxpayer in 1942 had beer paid by Warner Brothers (instead of by United Ar tists) taxpayer would have been required to return th payment as ordinary income for any one of the fol lowing three reasons: (a) Even if the transaction i looked upon as a completed sale Lasky had conveyec all of his rights under the York contract to Warne Brothers within much less than the holding perio under Section 117 of the Internal Revenue Code o 1939. Taxpayer admits the validity of this ground i his brief (p. 19) and explains his return in 1941 of th $196,216 from his share of the gross receipts on thi basis. (b) The Tax Court correctly regarded all th agreements with Warner Brothers as making up on transaction and Lasky's right to share in the proceed of the motion picture as due to his contribution as producer and as constituting additional compensatio and thus plainly ordinary income. (c) The amoun which Warner Brothers agreed to pay Lasky for hi rights, namely a percentage of the gross film rental of the motion picture, constituted royalties since al that Lasky acquired from York was a license upo which he was obligated to pay royalties to York an the arrangement with Warner Brothers was one unde which Warner Brothers was obligated to pay distinc royalties to two successive assignors of rights, whic were only a license.

The payment to taxpayer of the $805,000 in 1942 wa the payment of an amount of ordinary income whic had already been earned, accrued and accumulated i the transaction with Warner Brothers, and the cir

cumstance that the payment was made by a third party, United Artists, could not convert this accrued income into capital. Taxpayer's whole case turns on the circumstance that the payment was made to him not by Warner Brothers but by United Artists. If such a contention should be sustained there would be conferred on every taxpayer the power at his own choice and volition to convert earned ordinary income into capital gain through the simple device of "selling" the right to receive ordinary income at a discount to a third party. Congress in granting the favor of the capital gain rights authorized no such result. Simply because a contract may be denoted for some purposes as "property" does not change ordinary income, which has accrued under it, into capital. The Tax Court held taxpayer accountable for ordinary income on these past earned and accrued amounts and on nothing more. This holding, even assuming, *arguendo,* there was separate reality to the Lasky-United Artists transaction and that some other "property" was transferred to United Artists in addition to the accrued and earned income, is sustained by ample authority. An alleged "sale" of what has accrued as ordinary income does not convert accrued income into capital.

Additionally the Tax Court concluded on the facts that United Artists was a mere intermediary and the three-party transaction in reality was no more than termination of the Warner Brothers-Lasky participation agreement. In reaching this factual conclusion, the Tax Court on the instant record was certainly not clearly wrong. The Tax Court based its conclusion on the testimony of the six witnesses taken at the hearing and the rehearing, the documentary evidence and the record as a whole. This question was primarily for

determination by the trier of the facts, especially since there was substantial oral testimony and the credibility to be afforded to the witnesses is peculiarly for the fact finder who saw and heard them and possessed the opportunity to observe their demeanor upon the stand

ARGUMENT

The Record Amply Sustains the Tax Court in Concluding tha the Sum of $805,000 Which Taxpayer Received in 1942 I Taxable as Ordinary Income and Not as Capital Gain

A. *Under the record facts all payments which taxpaye received from Warner Brothers were ordinar income*

Taxpayer received substantial payments from War ner Brothers under the transaction with respect to the York photoplay and concededly reported all of these payments as ordinary—and not capital, income. Thus for the year 1940 taxpayer reported as ordinary income (R. 69) the $40,000 paid to him by Warner Brothers pursuant to the agreement of May 15, 1940 (under which Lasky sold to Warner Brothers all of his rights in the York story and all other rights he had acquired under the contract with York of March 23, 1940 (R 65)), as well as the $58,500 paid to him by Warner Brothers under the agreement of May 8, 1940 (R. 65) which employed him as producer. Again, in 1941 taxpayer received $196,216.80 from his share of the gross receipts of the distribution of the York picture (under the so-called "Supplemental Agreement" of May 15 1940 (R. 67-69)), which he reported in his return for 1941 as ordinary income (R. 71, 88). Indeed, in his brief (p. 19) taxpayer admits that he—

> reported the income under the contracts with Warner Bros. during the year 1941 as ordinary

> income because at the time of the sale to Warner Bros., he had not held the property rights in the contract with Sgt. York for the requisite holding period so as to be entitled to report the proceeds of the sale as long-term capital gain.

In other words, even under taxpayer's own reasoning, Lasky was required to return payments received from Warner Brothers in connection with the Sergeant York transaction as ordinary income, inasmuch as even if the transaction is looked upon as "a completed sale" Lasky had conveyed all of his rights to Warner Brothers within much less than the holding period.[1] (Br. 19.) The implication follows from the concession contained in taxpayer's own brief that if the $805,000 paid to Lasky in 1942 had been paid by Warner Brothers (instead of by United Artists) taxpayer would have been required to return the payment as ordinary income, precisely as he admittedly correctly returned as ordinary income the $196,216 percentage of gross rentals of the photoplay received in 1941.

As a matter of fact, however, the Tax Court correctly regarded all the agreements with Warner Brothers as making up one transaction (R. 87) and that Lasky's right to share in the proceeds of the motion picture was due to his contribution as a producer and constituted additional compensation, thus, for this additional reason clearly ordinary income, not capital gain

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[1] Section 117(a)(2) and (4) of the 1939 Code, as it read in 1940, provided for a holding period of eighteen months; in 1942 this period had been reduced to six months. See Section 117(a)(2) and (4), *supra*. Assuming without conceding that Lasky, having obtained rights from Sergeant York on March 23, 1940, "sold" them to Warner Brothers on May 15, 1940, he had held them for much less than the holding period before the purported "sale."

(R. 88). The Tax Court was plainly warranted on th record in looking at the transaction as a single inte grated unit. The so-called employment agreement, a though dated May 8, 1940, referred to the subsequentl dated agreement of May 15, 1940, under which Warne Brothers had purchased from Lasky the rights trans ferred to him by York. (R. 66.) Besides this employ ment agreement dated May 8, 1940, was under its term retroactive to April 1, 1940, and Lasky actually re ceived $1,500 a week from April 1, 1940. (R. 65-67. Indeed, under the agreement of May 15, 1940, Lask received only $40,000 (R. 67), namely, only $15,000 i excess of the $25,000 he had paid York, not taking int consideration the traveling and other expenses he ha incurred in obtaining the contract from York. Ac cordingly, while the so-called "Supplemental Agree ment," under which Lasky was to be paid a percentag of the gross receipts of the photoplay, is a separat document from the employment agreement, dated Ma 8, 1940, and from the agreement of May 15, 1940, unde which Lasky received the $40,000 payment (R. 67-69) the Tax Court surely might infer that all three agree ments in substance constituted one transaction. Indee taxpayer's testimony at the hearing fully sustains th Tax Court's conclusion that the transaction was single (R. 187-188, 199-200.) Submittedly there is warrant i the record for this factual conclusion and it is no clearly wrong.

Hence, the basic character of the transaction wa correctly found by the Tax Court to be one in whic taxpayer's participation in the gross receipts of th film rental constituted additional compensation due t his contribution as a producer and thus plainly ordinar

income. *Strauss* v. *Commissioner,* 168 F. 2d 441, 442-443 (C.A. 2d) certiorari denied, 335 U. S. 858; *Shuster* v. *Helvering,* 121 F. 2d 643 (C.A. 2d); *Shumlin* v. *Commissioner,* 16 T.C. 407.

Further the Tax Court also held that the amount which Warner Brothers agreed to pay Lasky for his rights, namely, a percentage of the gross film rentals of the motion picture, constituted "royalties." All Lasky had acquired from York was a license to produce a motion picture and what York was paid constituted royalties. (R. 64, 86-87.) It is immaterial that Warner Brothers also had to pay royalties to York. The arrangement was one under which Warner Brothers was obligated to pay distinct royalties to two successive assignors of rights, which were only a license. This result follows from taxpayer's assignment of the York contract. (R. 87-88.) *Sabatini* v. *Commissioner,* 98 F. 2d 753 (C.A. 2d); *Rohmer* v. *Commissioner,* 153 F. 2d 61 (C.A. 2d), certiorari denied, 328 U.S. 862; *Commissioner* v. *Wodehouse,* 337 U.S. 369.

Accordingly, under any one of the three grounds above stated payments to Lasky by Warner Brothers for his share in the gross rentals of the film constituted ordinary income.

B. *The payment to taxpayer of the $805,000 1942 was the payment of an amount of ordinary income which had already been earned, accrued and accumulated in the transaction with Warner Brothers and the circumstance that the payment was made by a third party, United Artists, could not convert this accrued income into capital.*

The finding of the Tax Court is not disputed and the record abundantly establishes that there was a balance

of earned income credited in taxpayer's favor on t
books of Warner Brothers as of November 28, 19
in the amount of $822,857.56, being the cumulat
amount of taxpayer's share of the gross receipts
the York picture, then earned due and owing to hi
(R. 78-79, 88-89, Ex. Z, R. 434.) There was nothi
contingent, indeterminate or tentative about t
amount; it was taxpayer's then and there—his earn
share of participation in the gross film rentals.

This amount was plainly subject to his dominion a
control. Indeed in the course of its accumulation
had actually been received by his attorney in 1942
the extent of $570,698.62 and returned. (R. 78.) T
Tax Court surely was warranted in inferring th
after the end of November, 1942, taxpayer could ha
obtained the entire $822,857.56 upon demand.
the Tax Court correctly pointed out (R. 91) this
not a case where indeterminate or future payments we
converted into a lump sum.

Had the $822,857.56, or the lesser $805,000, whi
Lasky actually received from United Artists abo
December 4, 1942 (R. 80), been paid him by Warn
Brothers, there can be no doubt (see subpoint A, *supr*
that it would have constituted a receipt of ordina
income; indeed, as already pointed out, taxpaye
brief (p. 19) impliedly concedes as much.

Thus taxpayer's whole case turns on the circumstan
that the payment was made to taxpayer not by Warn
Brothers, but by a third party, United Artists, taxpay
under date of December 4, 1942, having assigned
United Artists his claim against Warner Broth
for moneys past due as well as all of his interest in t
original and supplemental agreements of May 15, 19

(R. 81-82.) Surely if taxation is, as often said, a practical matter, the mere assignment of the right to receive this earned and accrued ordinary income did not convert the earned income into a capital asset. If such a contention should be sustained, there would be conferred on every taxpayer the power at his own choice and volition to convert earned ordinary income into capital gain through the simple device of "selling" the right to receive the ordinary income at a discount to a third party. By this expedient the taxpayer would readily save the substantial difference between the ordinary and capital gain tax rates, the third party would benefit through the receipt of quick discount money; only the Government would lose.

Certainly Congress in granting the favor of the capital gain rates authorized no such result. Indeed, provisions granting partial tax exemption, such as Section 117, must be strictly construed and a taxpayer must bring himself clearly within their terms, as the present taxpayer has not. *Sloane* v. *Commissioner,* 188 F. 2d 254, 259 (C.A. 6th).

Simply because a contact may be denoted for some purposes as "property" does not change ordinary income, which has accrued under it, into capital or turn into capital gain an amount paid for the assignment of ordinary income already owed and due under it. The statute deals in economic realities, not legal abstractions.

In October, 1942, two months prior to the Lasky-United Artists transaction, the picture "had been pretty well exploited domestically" (R. 142, 325) in the opinion of taxpayer's accountant, and subsequently in early December, when United Artists entered the scene, its president knew that the "big cream" (R. 144,

371) had been taken off and that it was in the phase
declining distribution. Taxpayer's representativ
knew (and plainly taxpayer himself knew or mu
be held to have known) before December 4, 1942, th
more than $805,000 was due him as his share of t
receipts (R. 90-91, 142, 330-331); and the president
United Artists knew of these accrued earnings al
(R. 144, 367-368, 369-370).

The Tax Court held taxpayer accountable for ord
nary income on these past earned and accrued amoun
and on nothing more. This holding, even assumi
arguendo there was separate reality in the Lask
United Artists transaction and that some other "pro
erty" was transferred to United Artists in addition
the accrued and earned income, is sustained by amp
authority (*Watson* v. *Commissioner*, 345 U.S. 54
affirming the decision of this Court 197 F. 2d 56). A
alleged "sale" of what has accrued as ordinary incor
does not convert accrued income into capital. Indee
the recent decision of this Court in *United States*
Snow, 223 F. 2d 103, certiorari denied, 350 U.S. 8
directly supports this principle. There this Cou
said (p. 108):

> However, it is not decisive of the issue he
> presented to find that the subject matter proper
> bears the capital asset label. It is a fundament
> principle of federal tax law that you must rega
> any ordinary income derived from an income-pr
> ducing capital asset as ordinary income. Cons
> quently, the assignment of accrued ordinary incor
> must be treated separately from the assignment
> the capital asset which produced the income. Th
> is not an exception to the rule that capital asse

held for more than six months shall be given capital gains tax treatment. It is only when a capital asset appreciates in value and is subsequently sold, beyond the six months' period, that the gain realized may be given capital gains tax treatment under Section 117 of the Internal Revenue Code.

The general rule is that a right to receive ordinary income, produced by a capital asset, is not transmuted into a capital asset by the sale or assignment of the capital asset together with the right to receive the ordinary income.

In the *Snow* case (p. 109) this Court quoted from and cited with approval the decision of the Sixth Circuit in *Fisher* v. *Commissioner,* 209 F. 2d 513, certiorari denied, 347 U.S. 1014, which constitutes further clear authority for the Commissioner's position here. See also *Hale* v. *Helvering,* 85 F. 2d 819 (C.A. D.C.); *Helvering* v. *Smith,* 90 F. 2d 590, 592 (C.A. 2d); *Rhodes' Estate* v. *Commissioner,* 131 F. 2d 450 (C.A. 6th); *Shuster* v. *Helvering, supra, Shumlin* v. *Commissioner, supra.*

Indeed, taxpayer's contention here would involve approval of anticipatory arrangements and contracts as a means of avoiding the ordinary income tax rates, analogous to devices repeatedly condemned by the Supreme Court. *Lucas* v. *Earl,* 281 U.S. 111; *Burnet* v. *Leininger,* 285 U.S. 136; *Helvering* v. *Eubank,* 311 U.S. 122. The payment here represented a right to income and its character as accrued ordinary income is not changed by the assignment. *Harrison* v. *Schaffner,* 312 U.S. 579. See also *Hort* v. *Commissioner,* 313 U.S. 28, where an amount substituting for future rental payments was held ordinary income. *A fortiori* in the in-

stant case the payment which substituted for past an accrued ordinary income must be held taxable as ord nary income. Indeed, the Tax Court pointed out tha this is not a case where indeterminate and future pay ments were converted into a lump sum. (R. 91.)

O'Brien v. *Commissioner,* 25 T.C. No. 48, decide November 30, 1955, relied upon by taxpayer (Br. 2- 25) is readily distinguishable. There a producer upo completion of a film sold one-half of his ten percer interest in its profits to the director of the picture for lump sum, but contrary to the record situation, no a signment of past-due earned and accrued ordinary in come was involved. Here on the other hand the a crued ordinary income exceeded in amount the sum pai to and received by the transferor-taxpayer. The Ta Court memorandum decision also cited by taxpaye (Br. 25), *Pacific Finance Corp. of Calif* v. *Commi sioner,* decided April 17, 1953 (1953 P-H T.C. Mem randum Decisions, par. 53,129) is similarly distinguis able.

Besides under the facts of the cited *O'Brien* case, there had been any past earnings of the picture to whi the producer there was entitled, such earnings mig not have ben ordinary income in his hands even if pa by R.K.O., since the situation there was unlike th here, where concededly Lasky had conveyed all h rights to Warner Brothers within much less than t holding period and all his receipts from Warner Brot ers were ordinary income.

C. *The Tax Court was not clearly wrong in holding that United Artists was a mere intermediary and the three-party transaction was no more than a termination of the Warner Brothers-Lasky participation agreement*

As discussed in the preceding subpoint B, even if the transaction between taxpayer and United Artists is considered to have independent reality separate from the subsequent United Artists-Warner Brothers agreement of a few weeks later, the $805,000 payment by United Artists to taxpayer representing no more than the accrued ordinary income due him from the gross rentals did not lose its character as ordinary income and must be taxable at ordinary income rates. However, the Tax Court concluded on the basis of the testimony of six witnesses taken at the hearing and rehearing of the documentary evidence and the record as a whole, that United Artists was a mere intermediary; that there was no showing of a business purpose to Lasky in Lasky's arrangement with United Artists; that the record does not provide any satisfactory explanation for the few days' advance of funds to Lasky, which United Artists so promptly recouped out of Lasky's account with Warner Brothers, through Warner Brothers' payment to United Artists of $820,000. This represented a gain to United Artists of $15,000 for about twenty days' use of the $805,000, which it had advanced to Lasky. (R. 90, 140-141.) The Tax Court concluded that there was no more than an ending of the Warner Brothers-Lasky agreement and Lasky received the accumulated earnings due him and that as a matter of fact and in reality there was only payment

of the total accruals to Lasky through an intermediar
(R. 91.)

The evidence warranted the Tax Court in conclu
ing on the record that taxpayer had failed to establis
that any real dispute existed in 1942 between him ar
Warner Brothers. At the most the record suggeste
only that Lasky and his advisers were suspicious th
possibly grounds existed for challenging Warn
Brothers' computations and accounting practice ar
procedure in their handling of the release of the fil
(R. 89.) But Lasky did not as much as authorize a
audit of Warner Brothers' accounting records and
his share in the receipts (R. 89, 140), even though h
had a clear right to such an accounting, had he so d
sired (R. 68-69). The Tax Court also noted that n
testimony was adduced from any executive of Warn
Brothers about any dispute with Lasky. It conclude
that Lasky's testimony did not establish that whatev
suspicions he may have had crystalized during 19
into issues constituting a real dispute. (R. 89.) I
deed, Lasky continued to work for Warner Brothe
during eighty-three weeks on various projects fro
January 11, 1943, to April 24, 1944, receiving $150,5
as an associate producer. (R. 70.)

In any event the Tax Court was warranted in infe
ring that by the end of 1942 Lasky decided to step ou
of its contract with Warner Brothers and to termina
it. In the agreement he made with United Artists o
December 4, 1942, he authorized United Artists to r
lease and discharge Warner Brothers from paying an
money due and owing to him and in turn United Artis
in the document it executed with Warner Brothe
on December 22, 1942, did so release and discharg

Warner Brothers. (R. 81-84, 89.) Warner Brothers in turn closed its account with Lasky and paid $820,000 in cash to United Artists, charging Lasky with the $2,857.56 balance to take care of some undisclosed adjustments. (R. 79-80, 89-90; Ex. Z, R. 434.)

The Tax Court also found that before he concluded the contract of purchase with Lasky, the president of United Artists gave consideration to the possibility of making a resale of Lasky's interest in the picture to Warner Brothers, that he had contacted an officer of Warner Brothers and told him that he had an opportunity to purchase an interest of Lasky's and inquired whether Warner Brothers would be interested in purchasing it. (R. 140, 143-144.) The president of United Artists had made up his mind from the start that United Artists would resell Lasky's interest in "Sergeant York" and before he agreed to purchase Lasky's interest he found out he could get a purchaser. (R. 44.) He intended making a short profit on the resale of Lasky's interests. (R. 143-144.)

As already noted above, in December, 1942, all the parties knew of Lasky's accrued earnings and also knew that the picture had been pretty well exploited at that time and that it was in the phase of declining distribution. Certainly the Tax Court was justified in concluding that Lasky could not through this transaction, involving his taking a discount of some $17,000 in the amount of earnings of the picture then due (R. 141), deprive the Government of taxes totaling almost $450,000.

The question of what the transaction between these three parties in reality was is a question of fact, and thus is primarily for determination by the trier of the

facts. *Commissioner* v. *Court Holding Co.,* 324 U. 331. The Tax Court's factual findings here susta ing the Commissioner's determinations are entitled finality "unless clearly erroneous." Rule 52(a), F eral Rules of Civil Procedure; Internal Revenue C of 1954, Section 7482(a) (26 U.S.C. 1952 ed., Su II, Sec. 7482). Rule 52(a) further provides: "* due regard shall be given to the opportunity of trial court to judge of the credibility of the witnesse Here there was substantial oral testimony and credibility to be afforded to the witnesses, includi interested witnesses, in view of all the circumstan of the case, is for the fact finder, who saw and hea them and possessed the opportunity to observe th demeanor upon the stand. *Grace Bros.* v. *Comm sioner,* 173 F. 2d 170, 174 (C.A. 9th); *Joe Balestri & Co.* v. *Commissioner,* 177 F. 2d 867, 873-874 (C 9th); *Earle* v. *Jones,* 200 F. 2d 846 (C.A. 9th); *Gre feld* v. *Commissioner,* 165 F. 2d 318 (C.A. 4th); *K Underwear Co.* v. *United States,* 127 F. 2d 965 (C 3d), certiorari denied, 317 U. S. 655,

As the Supreme Court said in *United States* v. Y *low Cab Co.,* 338 U. S. 338, 341:

> Findings as to the design, motive and *int* with which men act *depend peculiarly* upon credit given to witnesses by those who see a hear them. [Italics supplied.]

CONCLUSION

In the event that this Court denies the Commissi er's motion to dismiss the petitions for review here the ground that this Court is without jurisdiction, is alternatively urged that the decisions of the T

Court on the merits are correct and should be affirmed.[2]

Respectfully submitted,

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MARCH, 1956.

[2] As an alternate question on the merits the Commissioner urged in the Tax Court that $570,698.62 ordinary income was received by taxpayer in 1942 or was constructively received (R. 62) through the payments which Warner Brothers made to taxpayer, but which were returned (R. 76-78). Inasmuch as the Tax Court resolved the chief question in favor of taxpayer, it did not pass upon the Commissioner's alternate contention. In the event that this Court should disagree with the Tax Court on the merits it is requested that the case be remanded to the Tax Court for further consideration and decision on the Commissioner's alternate contention.

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